

**EAST-WEST BROADCASTING, INC.** (East-West) is a Black owned company that successfully used a tax certificate in its capital strategy. William Shearer made the transition from entrepreneurial manager to owner of radio station KGFJ-AM in Los Angeles, California. His significant operating experience in the radio business, his ability to provide owner equity, the minority tax certificate policy which served as encouragement to a motivated seller, and seller financing were key to his success.

As a new Account Executive at KGFJ-AM in Los Angeles, California, Bill Shearer learned the radio business while rising through the ranks. He was an Account Executive for eight years at four different stations and Vice President/General Manager for eleven years, including two years at KGFJ prior to its buyout.

Shearer's operating background positioned him to purchase KGFJ in 1986 when its owners, Inner City Broadcasting, decided to sell its Los Angeles stations. Inner City sold KUTE-FM relatively quickly, but had difficulty finding a buyer for KGFJ due to the limited market for AM stations. Inner City, seeking a minority buyer to provide tax certificate benefits and recognizing that an experienced Black entrepreneur such as Shearer would be a strong candidate, suggested that Shearer put a financing package together.

In August 1986, Shearer and a partner purchased KGFJ for \$4.5 million, providing a downpayment of \$100,000 and working capital of \$300,000. As President and Managing Partner of East-West and General Manager of KGFJ, Shearer owned sixty percent of the company. His partner, a Black physician in Los Angeles who was silent with respect to East-West's operations, obtained forty percent.

The balance of KGFJ's \$4.5 million purchase price was financed by Inner City in the form of senior and junior debt. East-West originally planned to borrow the senior portion of the debt from Wells Fargo Bank, but the Bank decided against the loan at the last minute. Inner City subsequently financed the purchase with the understanding that East-West would refinance the senior debt a year later.

In December 1987, East-West secured a \$1.4 million loan from Greyhound Financial Corporation to refinance Inner City's senior debt on schedule. At the same time, East-West exercised an option to pay Inner City an additional \$200,000 to extend its junior debt. Securing the Greyhound loan was not easy since it was East-West's first round of outside financing. Greyhound required the debt to be fully secured by the station's assets and the stock of the borrowers, as well as with the personal guarantees of Shearer and his wife.

In Shearer's opinion, minorities who want to own and operate a company must possess two critical ingredients, experience and equity. The quality of management is important to a lender, and financing is more easily available to operators with operating experience. Further, for a lender to provide financing, the entrepreneur must have equity to contribute. Shearer believed his ability to contribute personal funds was important to his lenders, and that the inability of many minority entrepreneurs to contribute personal equity is their major obstacle to business ownership.

**TELAMON CORPORATION (TELAMON)** is an Asian owned, value added reseller of telephone products and services formed by Dr. Albert Chen. Chen successfully used creative customer and seller financing as a substitute for traditional financing. A controlled growth strategy allowed Telamon to fund its expansion through retained earnings, adding bank financing only after the firm had a track record.

Telamon illustrates how management skills, business experience and relationships, strategic market selection, and judicious use of the Small Business Administration's 8(a) set aside vehicle can create a successful business. Telamon's ability to develop innovative solutions in technical, marketing, and financial applications also enhanced its success.

Prior to AT&T's divestiture, Chen spent thirteen years working for GTE, rising to the position of Materials Control Manager with 700 employees in GTE's largest materials management unit. A friend mentioned to Chen that his company was looking for outside sales assistance for its telephone and small interconnect systems. Although Chen had no prior sales experience, he was confident in his management and financial skills and abilities, and was anxious to start out on his own. Using \$9,000 in personal savings, and \$64,000 in long term asset based borrowings, Chen launched Telamon in late 1984, earning sales in the first year of \$378,000.

To position Telamon to compete for Regional Bell Operating Company ("RBOC") business, Chen leveraged Telamon's 8(a) status to secure government operations and maintenance management contracts. Having secured these contracts, Telamon successfully marketed its government experience to the competitive, but lucrative, RBOC segment. Telamon became a value added reseller of small, low-tech replacement parts and inventory, developed telephone loan and insurance products, and provided fulfillment services to the RBOCs. As the RBOCs increasingly downsized and outsourced activities, Telamon began providing them assembly rack and staging assistance to ensure that the RBOCs manufactured quality goods and delivered on time. Telamon's strategy was to win contracts before retaining resources to fulfill them. Only after experiencing strong internal growth did the company seek to expand through acquisition.

In November 1991, Chen proposed a \$1 million purchase of a division of the Siemens Company that provided loaner phones to RBOCs and others. Siemens agreed to accept a \$200,000 down payment on its accounts receivable with the balance due in two years; monthly installments for inventory over two years totalling fifty percent of their value with the remaining fifty percent paid on contingency; and a ten percent participation in the division's profits for two years.

Telamon today generates revenues of \$15,000,000 with total capitalization of over \$2 million. Dr. Chen is optimistic about Telamon's future. His strategic thinking and understanding of technology and finance should position Telamon solidly in the years ahead.

**BLACK ENTERTAINMENT TELEVISION HOLDINGS, INC. (BET)**, a Black owned telecommunications company, illustrates the role corporate partnering can play in financing a growing company, and how entrepreneurs can successfully develop companies from the startup stage to later stage exits. Robert L. Johnson leveraged his contacts and industry knowledge to build the dominant media company serving the Black consumer market. BET's initial financing was structured attractively for potential investors with equity from the founder, funding from an experienced corporate partner, and debt capacity to support expansion.

After serving three years as Vice President-Government Relations for the National Cable Television Association, Johnson, in August 1979, announced the creation of Black Entertainment Television. BET's initial financing comprised \$15,000 in equity from Johnson, an investment by Tele-Communications, Inc. (TCI) of \$500,000, and a loan to Johnson from TCI's President, John Malone.<sup>42/</sup> Soon after its inception, BET brought in Great American Broadcasting Company (formerly Taft Communications), sharing the firm's ownership between Great American and TCI (sixteen percent each) and Johnson (sixty-eight percent).

BET initially offered two hours of programming weekly to 3.8 million subscribers. As more cable systems began to carry the network, and with Time Warner Inc.'s Home Box Office and TCI providing capital and management assistance, BET grew to 34 million subscribers. The BET Cable Network is now in over half of all cable homes, and BET operates in four sectors of the telecommunications industry: broadcasting, cable, programming, and publishing.

By July of 1991, BET's revenues and retained earnings had grown to \$50 million and \$17 million, respectively.<sup>43/</sup> In September 1991, BET announced plans for an initial public offering ("IPO") under its newly established parent company, BET Holdings, Inc. That October, BET's stock was offered on the New York Stock Exchange, the first Black majority controlled company to do so,<sup>44/</sup> with BET receiving \$33.6 million in net offering proceeds.

BET continues to pursue joint ventures and strategic alliances in personal communications and other telecommunications sectors. The company expects to enjoy continued growth with its core cable network, and to finance investment opportunities through company cash flows capable of supporting an estimated \$100 million in additional debt. Johnson views BET's public offering as a model to encourage minority businesses to broaden their ownership.

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<sup>42/</sup> Paul Farhi, *Johnson's Dream of a Team*, *The Washington Post*, August 22, 1994, at 16.

<sup>43/</sup> *BET Holdings, Inc. Annual Report December 31, 1992*.

<sup>44/</sup> *Black Entertainment Television, Public Relations Department*.

While the preceding case studies provide a close look at the experience and successes of three minority telecommunications ventures, input from the resource group provided a broader perspective on capitalization and related issues that impact minorities in telecommunications.

## **RESOURCE GROUP FINDINGS**

In preparing this report, the research staff discussed minority telecommunications ownership and capitalization issues with a resource group of entrepreneurs, financial professionals, telecommunications policymakers and community representatives.<sup>45/</sup> This section summarizes the viewpoints, issues and concerns which arose most frequently in these discussions.

The resource group agreed that dramatic change would occur in the telecommunications industries, driven by technological evolution and convergence which in turn would blur industry lines, define competition and risk, and render existing industry segments obsolete. Members of the group also voiced concerns as to whether the regulatory framework would keep pace with technological change. The consensus was that consolidation in the telecommunications industry is stiffening barriers to entry, making strategic alliances with major players a key success factor for minority companies.

Financiers within the group perceived the most important factor in their investment decisions as being the abilities of minority telecommunications entrepreneurs. Capable minority managers with extensive corporate experience were considered particularly attractive financing candidates. The group thought that many of those most qualified were unaware of entrepreneurial opportunities, and that inadequate capital availability created a "chilling effect," dissuading them from pursuing entrepreneurship.

Other topics that the resource group found relevant to the problems of capitalizing minority telecommunications businesses are outlined below:

### **RESOURCE GROUP VIEWS ON MINORITY COMMUNITIES AND CAPITAL**

THERE IS A LACK OF UNDERSTANDING IN MINORITY COMMUNITIES THAT FINANCIAL RETURNS ARE REQUIRED TO ATTRACT CAPITAL;

A TREMENDOUS WEALTH GAP EXISTS BETWEEN MAJORITY AND MINORITY COMMUNITIES -- NONMINORITY ENTREPRENEURS WITH AN IDEA AND \$50,000 CAN FIND \$200,000 MORE;

CAPITAL IS NEEDED IN THE HANDS OF THOSE FOCUSED ON MINORITY MARKETS WHO ARE MORE INCLINED TO LOOK FOR AND KNOW MINORITY NETWORKS AND OPPORTUNITIES.

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<sup>45/</sup> Participants in the resource group are provided as Appendix C.

### **RESOURCE GROUP VIEWS ON STARTUP FINANCING FOR MINORITY BUSINESS**

CAPITAL IN AMOUNTS UNDER \$500,000 MUST BE OBTAINED FROM FRIENDS, FAMILY AND ASSOCIATES CLOSE TO THE ENTREPRENEURS AND THEIR BUSINESSES;

PRIVATE EQUITY WILL NOT RISK MINORITY STARTUPS, ARE NOT INVOLVED IN MEDIUM SIZED DEALS, AND WANT TO REENGINEER THE DEALS THEY ARE INVOLVED IN;

STARTUP CAPITAL IS THE GREATEST NEED; MANY GREAT IDEAS ARE TOO RISKY FOR CAPITAL CONSTRAINED INVESTMENT FIRMS;

AS VENTURE CAPITAL FIRMS HAVE BECOME MORE INTERESTED IN EXPANSION AND LBO FINANCING, SEED CAPITAL HAS DRIED UP;

VENTURE CAPITALISTS HAVE LITTLE EXPERIENCE FINANCING SMALLER (\$25,000) BUSINESSES.

### **RESOURCE GROUP VIEWS ON ACQUISITION FINANCING FOR MINORITY BUSINESS**

ACQUISITION FINANCING IS THE MOST URGENTLY DEMANDED TYPE OF CAPITAL, AS MANY OPPORTUNITIES EXIST IN NUMEROUS SECTORS WHERE THE ONLY ENTRY IS THROUGH ACQUISITION;

BLIND POOLS FOR LEVERAGED BUYOUTS AND OTHER ACQUISITIONS ARE IN HIGH DEMAND;

TAX CERTIFICATES AND OTHER INCENTIVES ARE NEEDED TO ATTRACT LONG TERM, "PATIENT" EQUITY; GOVERNMENT MUST PROVIDE AN EXTERNAL BOOST TO REDUCE PERCEIVED RISK AND COSTS FOR MINORITY FIRMS;

MATURE MANAGERS WILL NOT OPERATE SMALL STARTUPS, BUT WILL LEVERAGE LARGER AMOUNTS FOR LBO'S AND IPO'S;

THERE IS A NEED FOR INSTITUTIONS THAT MIX DEBT AND EQUITY INVESTMENTS, AS MANY VENTURES GENERATE INSUFFICIENT CASH FLOW TO SUPPORT ONLY DEBT, YET MAY HAVE INSUFFICIENT GROWTH POTENTIAL TO ATTRACT ONLY EQUITY; OTHERWISE INVESTORS BECOME OWNERS AND THE ENTREPRENEUR AN EMPLOYEE.

### **RESOURCE GROUP VIEWS ON EXPANSION FINANCING FOR MINORITY BUSINESS**

EXPANSION CAPITAL IS MOST CRITICALLY NEEDED, AS MANY ENTREPRENEURS BEGIN A BUSINESS BUT CANNOT GROW IT;

THE BETTER MINORITY COMPANIES HAVE OUTGROWN THE SBIC PROGRAM;

TRADITIONAL CAPITAL SOURCES ARE BECOMING AWARE OF THE DEMAND FOR MINORITY ENTERPRISE CAPITAL; LARGE INVESTMENT BANKS ARE LOOKING AT VENTURE TRANSACTIONS IN THE \$3 - \$5 MILLION RANGE UNFUNDED BY VENTURE CAPITALISTS OR SSBIcs;

ENTREPRENEURS MUST EDUCATE THE FINANCIAL MARKETS ON THE SIZE AND POTENTIAL OF MINORITY MARKETS;

INVESTORS MAY ASSUME MORE BUSINESS RISK, IF GOVERNMENT ASSUMES MORE "SOCIAL" RISK.

## **RESOURCE GROUP VIEWS ON PUBLIC MARKET FINANCING**

**RACIAL MINORITIES (E.G. BLACK, HISPANIC, ASIAN AND NATIVE AMERICANS) HAVE NOT UNDERSTOOD OR CREATED INSTITUTIONAL CAPITAL MARKET ACCESS LIKE ETHNIC (E.G. IRISH, ITALIAN, AND JEWISH-AMERICANS) MINORITIES;**

**SOME MINORITY COMPANIES COULD GO PUBLIC, BUT THEIR OWNERS OPT TO MAINTAIN THE "LIFESTYLE" THAT PRIVATELY OWNED BUSINESSES PERMIT;**

**ACCESS TO INITIAL PUBLIC OFFERING ("IPO") FINANCING BY MINORITY COMPANIES IS AN INCREASING NEED; FUTURE MARKETS MAY BE MORE RECEPTIVE;**

**MINORITY COMPANIES, IF THE MATURE STAGE IS REACHED, ARE NOW VIEWED FOR THEIR POTENTIAL AS IPO CANDIDATES;**

**EVEN WHEN SUCCESSFUL, IT IS MORE DIFFICULT TO GET PUBLICLY OFFERED CAPITAL FOR MINORITY BUSINESSES;**

**MINORITIES MUST MEET A HIGHER STANDARD TO OBTAIN EQUITY FINANCING;**

**GIVEN MANY GOOD NONMINORITY INVESTMENTS, FINANCIERS ARE RELUCTANT TO "STICK THEIR NECKS OUT" TO FINANCE A MINORITY;**

**LACK OF IPO CAPITAL MAY PREVENT A HUGE RUN UP IN EQUITY VALUES BUT DOES NOT PREVENT A MINORITY COMPANY FROM STARTING OR OPERATING COMFORTABLY;**

**MAINSTREAM INVESTMENT BANKS SEEK LARGE TRANSACTIONS IN EXCESS OF \$500 MILLION;**

**SEVERAL MINORITY PUBLICLY OWNED COMPANIES ARE IN TELECOMMUNICATIONS, SUGGESTING THAT PUBLIC INVESTORS MAY BE WILLING TO SUPPORT MINORITY TELECOMMUNICATIONS COMPANIES;**

**BET AND ENVIROTEST (BOTH PUBLICLY OWNED, MINORITY CONTROLLED COMPANIES) EMPLOY DIFFERENT STRATEGIES, ONE ORIENTED TO THE MINORITY MARKET, THE OTHER TO THE NONMINORITY MARKET; YET BOTH ARE DOING WELL, DEMONSTRATING THAT SIMILAR COMPANIES AND STRATEGIES CAN WORK.**

To summarize the resource group findings, minority businesses must overcome formidable barriers to telecommunications industry entry while employing success factors available in limited quantities within minority communities. No other success factor is more limited than capital.

## **CAPITAL INVESTMENT IN MINORITY BROADCASTERS**

To enhance our understanding of the experiences of minority companies seeking capital for telecommunications ventures, we examined one segment of the industry where minority participation has been most visible - broadcasting. From 1991 to 1993, the MTDP compiled annual listings of broadcast stations owned by Black, Hispanic, Asian and Native Americans, organized by station type (AM, FM, TV). The data showed that in 1993, minorities owned only 3.5% of all AM stations in the United States, 2.0% of all FM stations, and 2.3% of all TV stations. Moreover, the total number of minority owned

stations fell from 310 in 1992, to 300 in 1993, while total stations increased from 10,834 to 11,021 stations.<sup>46/</sup>

The MTDP figures confirm that minorities remain underrepresented as owners of broadcast properties. Although the aggregate totals describe the problem, they provide little indication as to its underlying causes. To understand better some of the barriers that minority entrepreneurs face in the broadcast industry, we discussed with minority station owners their most recent station acquisition. The 300 stations on the MTDP list belong to 186 different entrepreneurs. We spoke with 100 owners at random and received substantially complete responses from sixty.<sup>47/</sup> From these responses we created a series of variables mirroring those used in Bates' studies.<sup>48/</sup>

As shown in Appendix B, Table 1, a useful way to summarize the broadcast data is to look at the financial variables (Bank, Venture, and Institutional) by attributes of the owner and the acquired property. Analyzing the institutional financing variable by the owner's level of education and the profitability of the acquired station revealed the relationships among the variables.

Among owners lacking a graduate degree, the profitability of the station weighed heavily in their ability to attract institutional financing. Of those owners acquiring profitable stations, sixty-nine percent received some institutional financing. By contrast, only forty-seven percent of those acquiring unprofitable properties and twenty-two percent of those building new stations attracted bank loans or venture capital.

This sample suggested profitability may be a less crucial factor for more highly educated entrepreneurs. Owners with graduate degrees received institutional financing to acquire unprofitable stations in seventy-one percent of the possible cases. Among those owners acquiring new stations, eighty-three percent received institutional financing. This suggests that the institutional capital markets are willing to rely on the owner's human capital as a signal of creditworthiness, even when the broadcast property is new or unprofitable. On the other hand, owners with less attractive résumés had to rely more heavily on the acquired station's track record to obtain capital.

Bates and Bradford's statistical model revealed that an owner with management experience was significantly more likely to attract venture capital. By contrast, Bates did not find management experience a significant predictor of bank loan size. In our sample, we analyzed the institutional financing variable by education level and one measure of experience -- whether the entrepreneur owned other stations at the time of the acquisition.

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<sup>46/</sup> *MTDP, Analysis and Compilation by State of Minority-Owned Commercial Broadcast Stations* iv-vi (October, 1993).

<sup>47/</sup> The telephone survey was conducted by Quality Management International May 22 - June 2, 1994.

<sup>48/</sup> See Appendix B for a complete description of these variables.

As shown in Appendix B, Table 2, we found no positive relationship between a broadcaster's previous ownership experience and his/her ability to attract institutional financing. Among those owners with no previous experience and without a graduate degree, fifty-three percent obtained institutional financing. Those with previous ownership experience received bank loans or venture capital only slightly more often (fifty-seven percent.) Surprisingly, inexperienced owners with graduate degrees fared best in capital markets. Seventy-eight percent received some form of institutional financing, compared to seventy-one percent for experienced owners with graduate degrees.

The statistics suggest that investors consider two factors before committing capital to minority broadcasters -- a high level of educational attainment, or, for those without degrees, the profitability of the station to be acquired. Previous station ownership is apparently not as important in the investor's calculation. Of course, a number of other factors may affect whether a broadcaster receives institutional financing. To simultaneously control for these factors in a more rigorous fashion, we ran a logistic regression using institutional financing as our dependent variable.

The logistic regression indicates that education level plays a role in determining whether an owner receives institutional capital to finance an acquisition. Holding other factors constant, owners with graduate degrees were more likely to receive bank loans and venture capital than other owners. Those holding at least a college degree were more likely to acquire institutional capital than others, but the relationship was not statistically significant. Generally, it appears that only the most highly educated minority broadcasters fared well in institutional capital markets.

The profitability measure, however, did not perform well in the logistic regression. The coefficient on *Profit* indicated a positive but statistically insignificant relationship between a station's profitability and an owner's ability to attract capital.<sup>49/</sup> Ongoing stations, however, appeared to be at an advantage relative to new stations in acquiring capital--the coefficient on *New* was negative and statistically significant across all specifications of the model.<sup>50/</sup>

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<sup>49/</sup> This (i.e. whether a station was profitable (1) or not (0)) is not surprising as investors consider whether a station is profitable, as well as its level of profitability, when making investment decisions. Unfortunately, we could not gather enough reliable information on level of profitability and had to rely instead on a dummy variable.

<sup>50/</sup> In Appendix B, Table 5, Model 3, *New* was statistically significant at the  $\alpha = .06$  level. The coefficient on *New* should be interpreted as a comparison between owners building new stations and those acquiring unprofitable existing stations. In other words, new station owners are less likely to obtain institutional financing than owners acquiring unprofitable properties, making the result all the more striking.



We also noticed that southern stations comprised a much larger percentage of the sample than the region's share of U.S. population would otherwise warrant. Nearly fifty percent of the total, and sixty-two percent of the Black owned stations, are in the eleven states defined to be in the South. To test whether southern broadcasters faced less severe barriers to capital than broadcasters in other areas of the country, we included a dummy variable for southern states in the analysis.

The models indicated a negative and statistically significant relationship between minority ownership of stations in the South and access to institutional sources of capital. Although there were a large number of southern stations in the sample, their owners were typically less likely to receive institutional financing than were other station owners. This result could reflect a relatively limited supply of institutional capital in the South, or imply that the institutions that link savers with entrepreneurs are less well developed in these states. It does not necessarily imply, however, that discrimination against minorities in capital markets is more severe in southern states.<sup>51/</sup>

None of the remaining variables in the models -- the dummy variable for race, the age of the company that acquired the station, or the dummy variable for whether a broadcaster owned other stations at the time of the acquisition -- exhibited a statistically significant relationship with the dependent variable. Among minority broadcasters, neither experience nor membership in a particular minority group appeared to affect whether an owner attracted capital.<sup>52/</sup>

As shown in Appendix B, Table 3, we also estimated models using *Venture* (representing venture capital) as our dependent variable. These models were qualitatively similar to those for the institutional financing variable. For example, in both models owners with graduate degrees were more likely to attract capital. The age of the acquiring company and the dummy variable indicating whether the broadcaster had previous ownership experience remained statistically insignificant in the venture capital models.

The venture capital models did differ in certain important respects from the overall institutional financing models. Although still negative, the coefficients on the *South* and *New* dummy variables are no longer statistically significant in the venture capital model. Most strikingly, the profitability of the station is positively and significantly related to an owner acquiring venture capital. In the institutional financing models, the profitability coefficient,

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<sup>51/</sup> *It's possible that southern stations are overrepresented in our sample; not because of superior access to capital, but because of concentrations of minority communities in the South. In any event, the regression results merit further research.*

<sup>52/</sup> *The coefficient on the "Black" dummy variable is a measure of how Black owners fared relative to all other minorities in the sample.*

although positive, never achieved significance. Venture capitalists appeared to penalize new stations less and reward existing profitability more than bank managers.

While drawing inferences from small samples is difficult, these robust results inspire confidence. They indicate that in determining whether to provide financing to minority broadcasters, investors rely on readily identifiable signals -- most importantly, that the owner is highly educated. In addition, investors generally prefer that the broadcaster acquire an ongoing concern. Venture capitalists, moreover, appear to reward owners whose stations have a good track record. The entrepreneur's previous ownership record and the age of the acquiring company did not appear to significantly affect the investor's decision.

## **OTHER FACTORS RELATED TO MINORITY OWNERSHIP**

Although this report focuses on capital access and financial barriers for minority telecommunications firms, the research suggests that lack of capital is only one of several barriers to viable minority participation in telecommunications ownership. Other factors also appear to affect directly growth in minority telecommunications ownership, and indirectly, access by minority firms to conventional sources of capital. The results of the literature research, case studies, resource group discussions and econometric studies suggest that five factors, in particular, may impact this process:

- Minority tax certificates
- Government financing
- Education and training
- Employment
- Business selection

We briefly discuss these factors with the understanding that additional research should be undertaken to more fully understand their impact on minority ownership.

### **MINORITY TAX CERTIFICATES**

All of our case studies, resource group findings and surveys of minority broadcasters point to a positive impact from government initiatives in facilitating minority ownership, specifically the minority tax certificate program under Section 1071 of the Internal Revenue Service (IRS) Code. From 1978 to 1993, over 350 such certificates were authorized by the FCC.

The Tax Certificate Program is administered jointly by the FCC and the IRS. The FCC makes the determination that a purchaser and transaction qualifies to receive the certificate. The IRS determines whether replacement or reinvestment property qualifies for favorable capital gains tax deferral using the certificate.

In 1982 the FCC expanded application of the minority tax certificate to include investment in PCS and IVDS. Until that time, emerging technologies did not qualify for

such treatment. Programming, software and other exclusively content producing activities still do not qualify. Further, the narrow definition for reinvestment property (one-half of gross receipts from an entity's active conduct in broadcast or cable properties) is difficult to measure and to apply in today's converging telecommunications environment. Although the minority tax certificate policy has been effective in enhancing minority ownership in broadcasting and cable, the current policy is restrictive in its requirements for reinvestment, and does not apply to other important telecommunications sectors.

At the time of this writing, Congress had passed tax legislation (H.R. 831) which included a provision repealing the program. It should be noted that the Administration testified at the Finance Committee hearing on this legislation and opposed the outright repeal of the tax certificate program.

#### GOVERNMENT FINANCING

In the literature research, Professor Tim Bates suggested that if a primary goal of public policy is to create stable jobs for minorities, efforts should be focused on those companies most likely to remain in business. As noted above, among Black owned companies *not* located in large urban minority communities, viability is statistically linked to: (1) the owner's attending four or more years of college, (2) larger financial capital inputs at startup, and (3) the company's serving a racially diverse clientele.<sup>53/</sup> Bates defines such companies as "emerging" businesses<sup>54/</sup> and offers two reasons supporting a public policy focus on these firms.

First, minority owned companies, regardless of their size or location (urban or suburban), tend to hire minorities. Nonminority owned firms, on the other hand, tend to hire nonminorities, even when those firms are located in minority communities. For example, a survey of small businesses located in twenty-eight metropolitan areas indicated that eighty-seven percent of Black owned companies located in nonminority areas hire a workforce that is over fifty percent minority. By contrast, nearly one-third of the White owned small businesses located in minority communities hire no minorities.<sup>55/</sup>

Second, more widely crafted policies have proven less effective at generating real sustainable economic growth in minority communities. For example, in the late 1960s and early 1970s, the SBA's Economic Opportunity Loan program provided financing to many borrowers who could not otherwise attract capital. Bates and Donald Hester analyzed the SBA data and showed that "larger loans, other things being equal, were directly associated

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<sup>53/</sup> *Business Viability*, *supra* note 32, at 642.

<sup>54/</sup> *Banking on Black Enterprise*, *supra* note 6, at 17-18.

<sup>55/</sup> *Banking on Black Enterprise*, *supra* note 6, at 90-1.

with greater chances of failure."<sup>56/</sup> A later study by Bates and Bradford also found that weak, highly leveraged SBA borrowers were more likely to fail than less highly leveraged borrowers.<sup>57/</sup> Although these results pertain to different time periods and businesses, they underscore the risk of lending to firms lacking the necessary ingredients to succeed.

Telecommunications companies seem to fit the characteristics of "emerging firms" that could provide viable, long term business opportunities for minority entrepreneurs -- they have paid employees, often serve a racially diverse clientele, have high mean annual sales, and many of their owners have college degrees. Unfortunately, capital requirements appear to be greater for telecommunications companies than for firms in other industries.

Mobilizing institutional capital to minority telecommunications firms may require new programs to link investors with entrepreneurs.<sup>58/</sup> Such programs would be administered by a coordinating entity using criteria derived from statistics on business viability to screen potential investments, and match dollars raised by an entrepreneur privately. In time, approval by this new entity and the potential for matching dollars could be viewed as a signal of a firm's potential viability, easing other financial barriers for minority entrepreneurs.

This new coordinating entity could evaluate applications and actively search for attractive minority business opportunities. The program would be evaluated, not according to the number of entrepreneurs helped, but by its returns on invested tax dollars, with profits reinvested in other eligible minority ventures. If the program failed to generate sufficient returns, it could be discontinued.<sup>59/</sup> To attract skilled personnel and offer incentives for success, the program could be organized as a quasi-private venture in which managers would receive a share of the profits.

Existing research clearly indicates that to spur economic revitalization in minority communities, efforts should be focused on the most potentially viable minority owned firms. Regardless of their location, these firms provide the best prospects for sustainable minority employment. Any such program to increase business participation in telecommunications should attempt to discover viable firms in emerging business sectors and market them to

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<sup>56/</sup> *Banking on Black Enterprise*, *supra* note 6, at 57.

<sup>57/</sup> Timothy Bates and William D. Bradford, *Financing Black Economic Development*, (New York: Academic Press) (1979).

<sup>58/</sup> *Within the existing institutional framework, programs that foster educational advancement, thus enabling minorities to signal more effectively, may also help mobilize capital. In general, programs that enable minorities to invest in "human capital" may offer longer term solutions to capital constraints.*

<sup>59/</sup> "Sufficient" return would be measured relative to an accepted benchmark such as the S&P 500.

private investors. This strategy may best succeed if the organization acts as an intermediary between minority entrepreneurs and private investors.

## EDUCATION AND TRAINING

The literature research and the econometric study of minority broadcasters revealed a high correlation between a minority entrepreneur's educational attainment and resulting success in accessing capital. Given this finding, minorities must now be engaged through deliberate education and training to be reintegrated into the information age. Operating in competitive, large scale, capital intensive industries requiring highly trained managers and employees, minorities must develop the necessary knowledge and skills to assume leadership in information age companies which create jobs and strengthen communities.

Dr. Frank Fratoe, on the relationship between minority entrepreneurs, education and training offers:

The human capital inputs of minority entrepreneurs certainly have increased in the past two decades, with more years of schooling and greater likelihood of prior management experience. Self-employed minorities are now, on average, better educated than they were previously and record substantial income gains, but they still have some distance to go before catching their nonminority counterparts. Greater knowledge and wealth can fashion a larger capacity among minorities to create new technological advancements along with expanded productivity.<sup>60/</sup>

To consider the future of minority entrepreneurship, a 1992 Roper poll reported that ninety-six percent of the 500 Black entrepreneurs they surveyed would encourage their children, if asked, to go into their own business.<sup>61/</sup> Another study documented the strong interest in business ownership on the part of minority youth, with Blacks reporting the highest expectation of business ownership (38.1 percent), followed by Asian Americans (37.6 percent), Whites (35.5 percent), and Hispanics (28.5 percent).<sup>62/</sup> Despite their interest in becoming business owners, less than one-third of young adults interviewed knew of any place in their community where they could get advice on starting a business, and less than fifteen

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<sup>60/</sup> Frank A. Fratoe, Education/Training and Minority Business Development, Minority Business Development Agency, U.S. Department of Commerce (September 1991) at 1.

<sup>61/</sup> Turned Down, *supra* note 17, at R5.

<sup>62/</sup> Development Associates, Inc., Awareness and Attitudes of Minority Youth and Young Adults Toward Business Ownership, Developed for the Minority Business Development Agency, U.S. Department of Commerce (November 19, 1993) at III-33 (Minority Youth).

percent of the young adults had participated in any entrepreneurship or business ownership training.<sup>63/</sup>

Dr. Fratoe goes on to recommend (1) *advanced specialized training for minorities entering higher growth, technology based industries;* (2) *minority business training centers stressing advanced education and training for existing entrepreneurs;* (3) *private firms providing mentoring for minority enterprises, employing minority students as interns, and expanding on the job training for minority employees.*

These and other studies suggest that the capital formation and investment strategies presented in this report will be most effective if implemented with complementary education and training efforts for existing and potential minority entrepreneurs. Examples of such efforts may include:

- technology peer groups, advisers and advisory boards for small companies possessing technical capability but requiring support;
- broader mentor-protege programs linking startups with corporate mentors;
- a mechanism by which spectrum licensees could provide technology access and training to small businesses so that the latter maintain technological proximity;
- special efforts by the SBA and MBDA to provide technical assistance to businesses in the use of technology and in technology based businesses.

## EMPLOYMENT

Andrew Brimmer, relating employment, entrepreneurship and discrimination, estimated that racial bias deprived the American economy of \$215 billion in 1991, equal to 3.8% of the gross domestic product (GDP):

Historically, bias did not allow blacks to use their full qualifications. Today, despite equal opportunity laws, many blacks are still concentrated in positions that do not make full use of their talents. If racial bias were eliminated, blacks could migrate freely from low- to high-productivity occupations.... Another plus would be that self employed entrepreneurs- particularly blacks-would have greater market access and be more efficient, which would lead to higher productivity income and GDP.<sup>64/</sup>

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63/ *Minority Youth, supra* note 62.

64/ *Andrew F. Brimmer, The Economic Cost of Discrimination, Black Enterprise, November 1993, at 27.*

Numerous sources in the literature research attest to the vital role played by employment in the modern business formation process. Through employment, entrepreneurs may begin initial capital accumulation through wage savings, and are afforded the opportunity to develop general management skills, functional and technical knowledge, business judgement and experience. All of these components are helpful to entrepreneurial success. Undoubtedly, minority employment in technologically based telecommunications industries today, will be essential to creating a foundation for tomorrow's minority owned telecommunications companies.

## **BUSINESS SELECTION**

A critical ingredient to business success is a sound strategy which maximizes the assets of the individual and business in relationship to competitors and the market, and dictates how the company will create value. Given the profile of minority companies – young, small, undercapitalized, technology constrained – one critical aspect of a successful business strategy will be the business selection decision.

The minority telecommunications company fitting the typical profile is likely to compete at a disadvantage if success is dictated by large company size, longevity, capital assets, physical infrastructure, research and development budgets and like factors. Conversely, businesses will continue to emerge where the assets of minority companies provide competitive advantages: where markets may be too small to interest larger companies; where size is a liability; where followership is more profitable than technological leadership; where crucial market knowledge is proprietary.

The resource group, whose views are represented throughout this report, shared their insights and suggestions on business strategy for minority telecommunications firms:

### **RESOURCE GROUP VIEWS ON MINORITY TELECOMMUNICATIONS BUSINESS STRATEGIES**

CONDUIT (I.E. TRANSMISSION AND DISTRIBUTION) BUSINESSES REQUIRE MASSIVE CAPITAL; CONTENT (I.E. INFORMATION AND ENTERTAINMENT SOFTWARE, PRODUCTS AND SERVICES) BUSINESSES ALLOW FOR NICHE STRATEGIES;

SECURE DISTRIBUTION RELATIONSHIPS TO INTRODUCE NEW PRODUCTS AND SERVICES;

PROVIDE UNDERSTANDING OF MINORITY MARKETPLACES TO THOSE WHO WISH TO EMPLOY TECHNOLOGY THERE;

EXPLOIT THE INSIDE TRACK TO DIRECTLY SERVE MINORITY COMMUNITIES, BUT DON'T FOREGO OTHER MARKETS;

CARVE OUT A NICHE, BUILD SIZE AND SHARE COSTS, OR RISK DECLINE AND FORCED SALE IN CYCLICAL DOWNTURNS;

COMPLEMENT MAINSTREAM COMPETITORS AS "ANCHORS" OR "FILL-INS;"

AVOID FRONTAL COMPETITION WITH DOMINANT COMPANIES;

ALTER THE MARKET EQUATION WITH INNOVATION TO PENETRATE EXISTING SERVICES;

AGGREGATE LOW VOLUME DEMAND IN UNDERSERVED MARKETS TO ACHIEVE ECONOMIES OF SCALE;

BYPASS THE DOMINANT STRATEGY: GO LOW END IN A HIGH END BUSINESS, OR MASS MARKET IN AN UPSCALE BUSINESS;

PURSUDE GOVERNMENT CONTRACTS SEEKING NEW TECHNOLOGIES;

DO WHAT YOU ARE GOOD AT TO ACHIEVE COMPETITIVE ADVANTAGE.

Products and services identified by the resource group as offering special demand or opportunities for minority telecommunications businesses include bulletin boards, databases, proprietary software, on-line networks, multicultural products/services, educational and entertainment products/programming, local access cable services, electronic games/newspapers, and 800/900 telephone services.

The resource group findings highlight the fact that questions concerning size, scale, market and product selection, intersect at the business selection decision for many minority companies: to target minority markets, nonminority markets, or both. Minority markets may be selected by default; being accessible, familiar, less competitive, or attractive to businesses which have oversaturated other "ethnic enclave" markets.<sup>65/</sup> In such circumstances, small companies may operate profitably without a direct competitive threat from larger firms.<sup>66/</sup> Although there may be benefits to engaging in ethnic enclave businesses, including employment, entrepreneurial and community development,<sup>67/</sup> minority companies serving minority customers alone may relegate a business to "mom-and-pop" status, with chronically low profitability, and constant vulnerability to competition from better financed minority or majority firms.<sup>68/</sup>

Thus, the business selection decision involves careful evaluation of short, medium and long term considerations for minority businesses seeking to become self-sustaining in the telecommunications industries. The effect of these business selection decisions merits further

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<sup>65/</sup> Paul Ong and Karen Umemoto, *Life and Work in the Inner City, Economic Diversity, Issues and Policies*, 1994, at 102 (*Life and Work*).

<sup>66/</sup> *Interim Report of the Federal Communications Commission Small Business Advisory Committee* (April 21, 1994) at 14.

<sup>67/</sup> *Life and Work*, *supra* note 138, at 107

<sup>68/</sup> *Minority Entrepreneurship*, *supra* note 10, at 180.



examination and evaluation for its immediate impact on business formation, its medium term implications for minority business growth and viability, and its longer term contribution as a platform for minority business expansion. Such expansion may occur horizontally across other minority or nonminority markets, and vertically along the chain of telecommunications product and services which will constitute the National Information Infrastructure.

## **CONCLUSIONS**

The results from the case studies, resource group and statistical studies have common underlying themes. These efforts point to (1) the importance of education to minority capital access (2) the greater capital requirements needed to develop telecommunications businesses and (3) the real barriers minorities face in seeking capital at all phases of the business development cycle.

## Chapter Three

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### CAPITAL STRATEGIES

This chapter presents fifteen financing strategies minority entrepreneurs and telecommunications companies may use to access capital at different stages of their business development. These approaches augment the traditional financing vehicles discussed in the previous chapter, and highlight non-traditional approaches successfully in use by minority entrepreneurs in telecommunications and other industries.

**Strategies to Access Startup Financing:** Minority communities must address the finding that while minority business survival rates are on par with nonminority enterprises, minority business startup rates are low.<sup>69/</sup> Startup capital in many minority communities, characterized by higher unemployment, underemployment, and lower discretionary income and savings, is scarce. Such communities may increase capital aggregation at the individual level by increasing savings; at the group level by developing personal networks and relationships to leverage community resources; and at the institutional level through formal and informal capital formation programs.

**Strategies to Access Small and Mid-Sized Acquisition Financing:** There is growing demand on the part of experienced minority entrepreneurs seeking entry to capital intensive industries by purchasing existing competitors for acquisition financing. Acquisitions are especially attractive to capital constrained minority businesses. Perceived operating risk is reduced by beginning with an established business, a reputation, customer base, employees and supplier network. Perceived financial risk is also lessened with the presence of tangible assets and predictable income streams which can be used to collateralize debt and reduce equity needs.<sup>70/</sup>

**Strategies to Access Expansion Financing:** External financing is normally necessary for businesses to expand from startup through the growth phases. Minority businesses, even with track records demonstrating good performance, often do not receive sufficient expansion financing from traditional institutional sources

**Strategies to Access Public Market Financing:** To fully realize economic empowerment, minority communities will have to improve their access to institutional and public market financing. To do so, minority communities may benefit from initiatives and alliances on the part of minority money management, venture capital and investment banking professionals.

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<sup>69/</sup> *Minority Entrepreneurship*, *supra* note '10, at 167.

<sup>70/</sup> *It should be noted that Bates' econometric research on small business capitalization suggests that this strategy has been more effective for Whites than for Blacks. See, supra* page 30.

**START-UP FINANCING STRATEGIES**

**ROTATING CREDIT ASSOCIATIONS**

**INVESTMENT CLUBS**

**CHURCHES**

**MICROENTERPRISE PROGRAMS**

**STRATEGIC ALLIANCES**

## ROTATING CREDIT ASSOCIATIONS

Rotating credit associations, a long standing alternative to traditional financial institutions for aggregating small scale capital within ethnic communities, may provide a source of startup financing for minority companies entering less capital intensive segments of the telecommunications industry. Rotating credit associations are described as informal economic cooperatives indigenous to the cultures of Africa, Asia and the West Indies. The concept came to the United States with immigrants from Southern China, Japan and the West Indies, and was used to ease the economic transition to urban life in this country. Ethiopians, West Africans, Central Americans, Caribbean Blacks, Chinese, Vietnamese, Cambodian and Japanese all practice similar forms of community based capital formation.<sup>71/</sup>

One significant instance of a rotating credit association in the United States is the Korean Keh. Members of Kehs, usually trusted friends and acquaintances, meet periodically to contribute an agreed upon amount of money (the upper limits can reach \$100,000 monthly)<sup>72/</sup> and wait their turn to receive the group pot. A different member receives the pot each month, as determined by lot, negotiation, urgency of need, or willingness to pay for an early place in line. When each member gets his or her money back, the Keh dissolves.

Estimates are that \$100 million is working at any time in Washington, D.C. area Kehs alone,<sup>73/</sup> contributing to the area's Korean American population (estimated to be between 44,000 and 70,000) owning more than 4,000 businesses. Eighty percent of Korean-American households are thought to belong to at least one Keh.<sup>74/</sup>

The Keh also forms a connection which reinforces the benefits of "social capital" -- community bonding, advice, customers, suppliers and other resources. A member's inability to repay or continue carries an expectation to borrow or replace themselves in the Keh. This group obligation creates a powerful incentive to save at the expense of consumption. "The privations are real, but the Keh also offers an interest-free, tax-free, paper-work-free way for

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71/ Harold Cruse, Plural But Equal, 328 (1987). Joel Garreau, For Koreans, 'Keh' Is Key to Success, The Washington Post, November 3, 1991, (Korean Kehs). Joel Millman, Out of Africa-Into America, the Washington Post, October 9, 1994. Lena Sun, Traditional Money Pools Buoy Immigrants' Hopes, The Washington Post, February 17, 1995 (Traditional Money Pools).

72/ Korean Kehs, supra note 71.

73/ Korean Kehs, supra note 71.

74/ Korean Kehs, supra note 71.

people with little or no credit history, or capital, or knowledge of the American banking system, or even knowledge of English, to accumulate substantial piles of money."<sup>75/</sup>

Another example of a rotating credit association is the Bolivian "*pasanaqu*", in Indian meaning literally to "pass from hand to hand." In Washington's Bolivian community, numbering between 60,000 to 80,000, one businesswoman has organized a *pasanaqu* annually for the last fifteen years. The same practice, also known to Ethiopians as "*Ekub*", is also widespread among Washington's 25,000 member Ethiopian community, the largest in the United States.<sup>76/</sup>

## INVESTMENT CLUBS

Similar to rotating credit associations, investment clubs can be a mechanism for small scale private capital aggregation and investment for groups with limited economic resources. Investment clubs normally consist of ten to twenty people who know each other socially and meet periodically to enjoy the benefits of group investing. Groups determine their investment objectives, legal structure, officers, and dues or deposits (which average \$32 per month nationally) to be set aside and invested on a regular basis. Clubs then meet regularly to share investment insights and research before deciding upon investments.

More than 8800 investment clubs are registered with the National Association of Investment Clubs, with combined assets totaling more than \$20 billion and an average portfolio size of \$89,000.<sup>77/</sup> Black Enterprise reports that a single individual, inspired by the principles of collective work and cooperative economics, formed ten investment clubs with more than 150 members in only three years.<sup>78/</sup>

Investment clubs normally invest long term in the public securities markets.<sup>79/</sup> Investment clubs may also be used by groups interested in more active participation in the growing telecommunications sector.

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<sup>75/</sup> Korean Kehs, *supra* note 71.

<sup>76/</sup> Traditional Money Pools, *supra* note 71.

<sup>77/</sup> Carolyn M. Brown, How to Start an Investment Club, *Black Enterprise*, April 1993, at 50 (*Investment Club*).

<sup>78/</sup> George Fraser, Tapping into the Power of Networking, *Black Enterprise*, July 1994, at 63.

<sup>79/</sup> Roger Barnes, Investment Clubs for Profit and Fun, *Black Enterprise*, September 1990, at 5; Carolyn Hughes Crowley, Many Happy Returns, *The Washington Post*, February 8, 1991, at 5B.

## EXAMPLES

The long term goal of Family 7, Inc. ("Family 7"), founded in 1985 by seven members of the Evans family in Linden, NJ, was "to establish solid, family controlled businesses in the tradition of famous American dynasties such as the Hearsts, Fords and Kennedys." Family 7's members aim for long term growth and reinvestment; make decisions by majority rule; meet on a quarterly basis; and target substantial increases in its portfolio every five years. Most investment clubs which invest passively in stocks and bonds are organized as limited partnerships. Family 7 was organized as a corporation, however, to insulate individual family members from claims of creditors and investors in businesses it sought to create. Expanding its scope from blue chip stocks, mutual funds and bonds, the family began purchasing real estate in its third year. By 1990, Family 7, had amassed a portfolio of stocks, bonds, mutual funds and real estate valued at \$2.3 million.<sup>80/</sup>

The Washington Women's Investment Club ("WWIC") was formed by twenty-one Black women in Washington, D.C. in 1987. Through 1993, WWIC built a portfolio of stocks, mutual funds and loans totalling \$150,000, while averaging an annual return of approximately twenty percent. In addition to its regular investment committee, WWIC also evaluates direct investments in real estate and business ventures through its real estate and entrepreneurial committees.

## CHURCHES

An indigenous capital development resource within the Black community is the church. The Black church has played a historic role in the personal and financial capitalization of Black communities.<sup>81/</sup> According to Emmett D. Carson, author of *A Hand Up: Black Philanthropy and Self Help In America*, ninety percent of all Black giving is channeled through the church, "making it the one enduring institution in low-income black communities with the ability to secure major credit."<sup>82/</sup>

A 1993 survey by the National Baptist Convention revealed that in the New York metropolitan area, 600 churches deposited \$152 million annually in twenty-one banks, and borrowed \$40 million in loans. In other words, "every Monday morning, these churches

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80/ Donna Whittingham-Barnes, *The Family that Saves Together*, *Black Enterprise*, October 1990, at 54.

81/ W. Franklyn Richardson, *Mission to Mandate: Self-Development Through the Black Church*, *The State of Black America 1994* (1994) at 114 (*Black Churches*).

82/ Lloyd Gite, *The New Agenda of the Black Church: Economic Development for Black America*, *Black Enterprise*, December 1993, at 56.

deposit over \$3 million in New York banks." Estimating the annual income of Black churches at \$2 to \$3 billion, Reverend W. Franklyn Richardson adds, "Our churches have millions of dollars invested in banks. We must ensure that banks reinvest in our communities."<sup>83/</sup>

Churches are creating 501(c)(3) nonprofit foundations and community development corporations to protect their tax-exempt status while receiving subsidies, grants and donations from federal, state and city governments, major corporations, private foundations and individuals to open businesses and revitalize their communities. According to John W. Handy, Morehouse College's Chairman of Economics, churches possess experience in balancing budgets, making payrolls and working with accountants and lawyers, giving them an advantage over individual entrepreneurs.<sup>84/</sup> Further, like other "social capital" networks, many Black churches have lawyers, accountants and businessmen in their congregations who the church can rely upon for expertise.

Community investment by Black churches takes a variety of forms, including loan funds, credit unions and "worker-owned businesses." Common to successful programs are the hiring of experienced professional managers and the research and preparation of well defined business plans. Although most church enterprises are in real estate, retailing and social services, their scope may change as community needs grow in the areas of business and technology services.

#### EXAMPLES

##### FIRST AFRICAN METHODIST EPISCOPAL CHURCH, LOS ANGELES, CA:

Received a \$1 million grant from the Walt Disney Company to create a microloan program which supplies low interest loans of \$2000 to \$20,000 to minority entrepreneurs. The program approved thirty-four loans totaling more than \$500,000. The church's long range goal is to capitalize the program with \$10 million in private sector funding.

##### ALLEN A.M.E. CHURCH, QUEENS, NY:

Established a home care agency, a senior citizen's home, multiservice center housing, prenatal and postnatal clinics, a bus company, a fuel cooperative, a private school, and commercial real estate. Church revenues grew from \$250,000 in 1976, to \$21,000,000 in 1991. The church allocates one-third of its \$3 million in annual collections for development projects, and was negotiating to buy two fast food franchises.

<sup>83/</sup> *Black Churches*, *supra* note 81, at 117.

<sup>84/</sup> Krystal Miller, *Enterprise: More Black Churches Go Into Business*, *The Wall Street Journal*, January 27, 1993, at B1

## MICROENTERPRISE PROGRAMS

In March 1994, there were over 200 microenterprise programs in the United States. A microenterprise is a business operating as a sole proprietorship or partnership with fewer than five employees and initial credit needs of less than \$10,000. The term describes more than ninety-six percent of U.S. minority enterprises. A microenterprise program is usually operated by a nonprofit organization that provides small loans, training and technical assistance to microenterprises.<sup>85/</sup>

Private sector foundations, corporations and community development organizations took the lead in creating U.S. microenterprise programs almost a decade ago. For example, the Charles Stewart Mott Foundation, as of 1992 had spent over \$6,000,000 to fund twenty-three microloan programs run by development organizations that had generated 1200 businesses (about half minority owned).<sup>86/</sup> Following the private sector's lead, Federal and state governments have initiated microenterprise efforts to leverage community organizations' relationships and expertise as intermediary lending and technical assistance providers.

In June 1992, the SBA launched a five year Microloan Demonstration Program to fund direct loans to existing microenterprise intermediaries which, in turn, fund microborrowers. The intermediaries can be private nonprofits, community development corporations, or economic development agencies making short term, fixed interest loans of \$100 to \$25,000 to startup and fund existing microenterprises. As of March 1994, the SBA had authorized \$58 million to over ninety-six intermediaries who had made 1123 loans to microbusinesses averaging about \$10,000 each.<sup>87/</sup>

According to Dr. Frank Fratoe, successful microenterprise programs combine financial capital (loans), human capital (training) and social capital (group support) with linkages to the local and business communities. Such programs usually offer basic business training (human capital) to prospective borrowers in planning, accounting, marketing, and other essential skills. Loans (financial capital) for up to \$25,000, well below the level of most venture capital and institutional startup financing sources, are made to individual owners directly or through lending circles of several people who receive funding on a

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85/ Frank A. Fratoe, *Microenterprise Programs in the United States: Support-Group Strategies For Small And Minority Business Development*, Minority Business Development Agency, U.S. Department of Commerce (March 1994) at 2 (*Microenterprise Programs*).

86/ *Microenterprise Programs*, *supra* note 85, at 14.

87/ Statement of Cassandra Pulley, Deputy Administrator, U.S. Small Business Administration before the Committee on Small Business, United States Senate (March 17, 1994) (On file at NTIA).



revolving basis. Loan money, once repaid, recirculates into business development and community wealth generation.

Fratoe recommends that assistance to medium and large size minority businesses be supplemented with a microenterprise strategy to reach beginning small scale minority owners, perhaps by MBDA in conjunction with the SBA five year demonstration project. Additionally, microenterprise programs could be operated by foundations and other organizations focused on the telecommunications industry, using strategically located business and technology training facilities as microenterprise centers. This approach could apply microenterprise strategies to the lack of seed capital for minority owned, technology based businesses which, once started, can be developed with venture capital and management expertise to form the basis for later stage minority businesses.

The following are representative of microenterprise programs in communities throughout the U.S.<sup>88/</sup>

#### EXAMPLES

##### NORTH CAROLINA RURAL ECONOMIC DEVELOPMENT CENTER (NCRED):

The State of North Carolina and private foundations provided a loan capital fund of \$3.6 million. The organization has made approximately sixty loans of \$500 to \$8,000 and targets low income minorities and female residents in nonmetropolitan counties. It makes loans to groups of four to five clients who must participate in a five step entrepreneurial training program. The group decides when and how much each is ready to borrow. No one else receives capital until all current borrowers have made four payments.

##### COALITION FOR WOMEN'S ECONOMIC DEVELOPMENT:

Serves urban low income residents in living in the inner city of Los Angeles. From 1988 to 1993, the coalition provided nearly 150 clients with loans totaling \$350,000. It lends to individuals or through group solidarity circles where four or five borrowers guarantee each others' loans and meet regularly to discuss problems and plans. In 1992, obtained a \$750,000 expansion grant from the SBA.

#### STRATEGIC ALLIANCES

We have noted several times in this report that a company's competitive strategy can include strategic alliances, joint ventures and corporate partnerships. Such alliances may be particularly appropriate to pursue government procurement contracts or to serve specialty

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88/ *Microenterprise Programs*, *supra* note 85, at 17-23; Frank A. Fratoe, *Rural Minority Business Development*, *The Review of Black Political Economy*, Fall 1993, at 56.